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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 395

STIMSON MILL COMPANY, A CORPORATION,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE NINTH
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 21-40) are reported in 7 T. C. 1065. The opinion of the Circuit Court of Appeals for the Ninth Circuit (R. 61-80) is reported in 163 F. 2d 269.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 21, 1947. (R. 81.) The petition for a writ of certiorari was filed October 13,

1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Circuit Court of Appeals erred in affirming the Tax Court's decision sustaining the Commissioner's denial of the taxpayer's claim for general relief, under Section 722 of the Internal Revenue Code, from the excess profits taxes assessed against it for the taxable year 1942.

STATUTES AND REGULATIONS INVOLVED

The pertinent statute and Treasury Regulations are set out in the Appendix, *infra*, pp. 10-16.

STATEMENT

The Tax Court found the facts as stipulated. (R. 22-27.) These may be summarized as follows: The Commissioner determined an additional excess profits tax liability against the petitioner for the taxable year 1942 in the sum of \$2,106.08, making a total tax liability for that year of \$251,368.42 (R. 22-23), which the petitioner does not contest, except by reason of its claim that it is entitled to relief therefrom under Section 722 of the Internal Revenue Code, in addition to the benefits provided by Section 713 (e) (1). Accordingly, it was agreed that the proposed deficiency in the amount of \$2,106.08 as set forth in the statutory notice of deficiency was

due and had properly been assessed by the Commissioner since the petition for review by the Tax Court was filed by it. (R. 26.)

In determining the excess profits tax liability of the petitioner for the taxable year, the Commissioner computed its excess profits credit, based upon the average base period net income under Section 713 (e) (1). In making such computation, the Commissioner used the petitioner's actual income for the base period years 1936, 1937 and 1939, and 75 percent of the average of those years as its base period net income for its low income year 1938, as required by Section 713 (e) (1). In this manner, the Commissioner computed the petitioner's Section 713 (e) (1) excess profits credit in the sum of \$78,662.68. (R. 23-24.)

The petitioner made timely application to the Commissioner for relief under Section 722 from the excess profits tax thus determined, on the form provided therefor, claiming a refund of such tax for 1942. (R. 22.)

The petitioner established by information submitted that its normal operations or output was interrupted in 1937 by strikes or other events peculiar in its experience, of the character provided for by Section 722 (b) (1). It also established that, because of those events, its actual earnings for 1937 in the amount of \$63,706.57 were abnormally low. On the basis of the facts

submitted, the fair and just amount representing normal earnings, which would be used by the petitioner as its constructive average base period net income for the year 1937 under the provisions of Section 722 (exclusive of Section 713), was accordingly reconstructed by the Commissioner in the amount of \$85,263.34. (R. 24-25.)

In computing the petitioner's excess profits credit under Section 722, the Commissioner used this amount (\$85,263.34), as representing the petitioner's normal base period net income for 1937, and its actual net income for the years 1936, 1938 and 1939. The excess profits tax credit thus determined by him under Section 722 was \$77,105.22. (R. 25.)

Since such Section 722 credit (of \$77,105.22) was less than the excess profits credit of \$78,662.68 computed under Section 713 (e) (1) (R. 23-24), the Commissioner disallowed the petitioner's claim for Section 722 relief, and notice of such disallowance was issued by him in accordance with the requirements of Section 732. (R. 23.)

The petitioner, on the other hand, contended that it was entitled under the law to compute its excess profits credit for 1942 by reconstruction of its base period net income (for 1937) under Section 722, as above set forth, and also by the application of the provisions of Section 713 (e) (1). This would result in an excess profits credit of \$85,062.32, computed by using its actual net

income for the years 1936 and 1939 and its net income as reconstructed under Section 722 (b) (1) for 1937, and by taking 75 percent of the average of these amounts as representing its net income for 1938. (R. 25-26.)

It was further stipulated that, if it was held in accordance with the Commissioner's determination that the petitioner was not entitled to Section 722 relief in addition to the benefits allowed by Section 713 (e) (1), the Tax Court could enter its decision that the petitioner's correct excess profits tax liability for 1942 was the stipulated amount \$251,368.42. (R. 26-27.) But, if it was held in accordance with the petitioner's contention that it was entitled to compute its excess profits credit for that year by using both Section 722 and Section 713 (e) (1), then it was agreed that such credit was to be computed in accordance with its contention above set forth and that it had overpaid its excess profits tax for that year in an amount to be determined by the Tax Court under its Rule 50. (R. 27.)

The Tax Court sustained the Commissioner's denial of the petitioner's claim for general relief from the excess profits tax, under Section 722, and the Circuit Court of Appeals affirmed the Tax Court's decision. (R. 80.)

ARGUMENT

1. The petitioner's sole claim is for general relief from the excess profits tax under Section

722 of the Internal Revenue Code (Appendix, *infra*, pp. 11-13). It contends that, in denying such relief, the Commissioner, the Tax Court and the Circuit Court of Appeals erred in misconstruing and misapplying its provisions and, in this connection, that the applicable Treasury Regulations similarly construing the statute are invalid (Treasury Regulations 112, Section 35.722-2, Appendix, *infra*, pp. 14-16). The question thus presented has not been passed on by any other appellate court, and there is thus no conflict of authority. It is submitted that the case is not one calling for review by this Court.

2. There is no proper basis for review, because the question as to the construction and application of Section 722 would, in all probability, not be reached by this Court at all, since the Circuit Court of Appeals was without jurisdiction under Section 732 (c) (Appendix, *infra*, p. 14) to review the Tax Court's decision denying the petitioner Section 722 relief, and this was the only matter before the Circuit Court of Appeals.

In this connection it may be observed that it was stipulated that the excess profits tax in question was properly determined by the Commissioner after allowance of an excess profits credit duly computed under Section 713 (e) (1), as amended by Section 215 of the Revenue Act of 1942 (Appendix, *infra*, pp. 10-11). (R. 26.) It is now well

settled that a claim for refund based on a claim for Section 722 relief cannot, under Section 722 (d) (Appendix, *infra*, p. 13), be filed until the tax shown upon the return has been paid (*Uni-Term Stevedoring Co. v. Commissioner*, 3 T. C. 917) or until any deficiency determined by the Commissioner has become final and been assessed and paid. (*American Coast Line v. Commissioner*, 159 F. 2d 665 (C. C. A. 2d); *Pohatcong Hosiery Mills, Inc. v. Commissioner*, 162 F. 2d 146 (C. C. A. 3d)).

Thus, in this case the petitioner filed its claim for refund only after the Commissioner had determined the amount of the petitioner's excess profits tax for the taxable year in question to be \$251,368.42 (R. 22-23), which, as stated, was agreed to be the amount due and properly assessed. (R. 26.)

When, therefore, the Commissioner denied the petitioner's claim, the petitioner appealed under Section 732 to the Tax Court only to review such denial. Subsection (c) of Section 732 (Appendix, *infra*) provides that the decision of the Tax Court on such appeal shall be final in respect of any question the determination of which was necessary solely by reason of Section 722. And, since, as stated, the petitioner did not appeal from the Commissioner's determination of the deficiency in the tax, but only from his denial of its claim to Section 722 relief, the question pre-

sented both to the Tax Court and to the Circuit Court of Appeals was one necessary solely by reason of Section 722, within the meaning of Section 732 (c). Plainly, therefore, the court below should have dismissed the case for want of jurisdiction. Compare its own prior decision in *James F. Waters, Inc. v. Commissioner*, 160 F. 2d 596, which involved the construction and application of Section 721.

3. In any case, the petitioner points to nothing in either Section 713 or Section 722 which justifies a conclusion that it is entitled to a hybrid credit computed under both Section 713 (e) (1) and Section 722. As regards the petitioner's contention that its construction of Section 722 is supported by the provisions of the prior law, particularly Section 722 (b) (3) as amended by Section 6 of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, it need only be pointed out that the amendments made by the Revenue Act of 1942 in Section 722, particularly in subsection (e) thereof, relating to the rules for the application of the section, entirely omitted the requirement contained in Section 722 (b) (3), as amended by Section 6 of the Excess Profits Tax Act of 1941, that the constructive average base period net income computed under Section 722 (a) be determined in accordance with the computation of the average base period net income under Section 713. There is nothing in the legis-

lative history which justifies a contrary conclusion. Accordingly, even assuming the Circuit Court of Appeals had jurisdiction to determine the proper construction of Section 722, the construction which it made was correct.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for certiorari should be denied.

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NOVEMBER 1947.

APPENDIX

Internal Revenue Code:

SEC. 713 [as added by the Second Revenue Act of 1940, c. 757, 54 Stat. 974, Sec. 201]. EXCESS PROFITS CREDIT—BASED ON INCOME.

* * * * *

(d) [as amended by the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, Sec. 4] *Average base period net income—Determination.*—

(1) *Definition.*—For the purposes of this section the average base period net income of the taxpayer shall be the amount determined under subsection (e), subject to the exception that if the aggregate excess profits net income for the last half of its base period, reduced by the aggregate of the deficits in excess profits net income for such half, is greater than such aggregate so reduced for the first half, then the average base period net income shall be the amount determined under subsection (f), if greater than the amount determined under subsection (e).

* * * * *

(e) [as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 215] *Average base period net income—General average.*—The average base period net income determined under this subsection shall be determined as follows:

(1) By computing the aggregate of the excess profits net income for each of the

taxable years of the taxpayer in the base period, reduced by the sum of the deficits in excess profits net income for each of such years. If the excess profits net income (or deficit in excess profits net income) for one taxable year in the base period divided by the number of months in such taxable year is less than 75 per centum of the aggregate of the excess profits net income (reduced by deficits in excess profits net income) for the other taxable years in the taxpayer's base period divided by the number in such other taxable years (herein called "average monthly amount") the amount used for such one year under this paragraph shall be 75 per centum of the average monthly amount multiplied by the number of months in such one year, and the year increased under this sentence shall be the year the increase in which will produce the highest average base period net income;

* * * * *

(26 U. S. C. 1940 ed., Sec. 713.)

SEC. 722 [as added by the Second Revenue Act of 1940, *supra*, Sec. 201]. GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME

(a) [as amended by the Revenue Act of 1942, *supra*, Sec. 222 (a)] *General rule.*—In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon comparison of normal earnings and earn-

ings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. In determining such constructive average base period net income, no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally occurring or existing after December 31, 1939, except that, in the cases described in the last sentence of section 722 (b) (4) and in section 722 (c), regard shall be had to the change in the character of the business under section 722 (b) (4) or the nature of the taxpayer and the character of its business under section 722 (c) to the extent necessary to establish the normal earning to be used as the constructive average base period net income.

(b) [as amended by the Revenue Act of 1942, *supra*, Sec. 222 (a)] *Taxpayers using average earnings method.*—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—

(1) in one or more taxable years in the base period normal production, output, or operation was interrupted or diminished because of the occurrence, either immediately prior to, or during the base period, of events unusual and peculiar in the experience of such taxpayer,

* * * * *

(d) [as amended by the Act of December 17, 1943, 346, 57 Stat. 601, Sec. 1] *Application for relief under this section.*—The taxpayer shall compute its tax, file its return, and pay the tax shown on its return under this subchapter without the application of this section, except as provided in section 710 (a) (5). The benefits of this section shall not be allowed unless the taxpayer within the period of time prescribed by section 322 and subject to the limitation as to amount of credit or refund prescribed in such section makes application therefor in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter for a subsequent taxable year.

* * * * *

(26 U. S. C. 1940 ed., Sec. 722.)

SEC. 732 [as added by the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, Sec. 9]. REVIEW OF ABNORMALITIES BY BOARD OF TAX APPEALS.

(a) *Petition to the Board.*—If a claim for refund of tax under this subchapter for any taxable year is disallowed in whole or in part by the Commissioner, and the disallowance relates to the application of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, relating to abnormalities, the Commissioner shall send notice of such disallowance to the taxpayer

by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the tax under this subchapter. If such petition is so filed, such notice of disallowance shall be deemed to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayments.

* * * * *

(c) *Finality of determination.*—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Board.

* * * * *

(26 U. S. C. 1940 ed., Sec. 732.)

Treasury Regulations 112 promulgated under the Internal Revenue Code:

SEC. 35.722-2. *Constructive average base period net income.*—

* * * * *

(b) *Rules for determination.*—The determination of the constructive average base period net income must depend in each instance upon the facts and circumstances presented by the taxpayer and upon the provisions of section 722 forming the basis of the taxpayer's contention that its excess profits tax is excessive and discriminatory,

i. e., if the taxpayer is entitled to use the excess profits credit based on income, the reasons why such credit is an inadequate standard of normal earnings, or if the taxpayer is not entitled to use such credit, the reasons why the excess profits credit based on invested capital is an inadequate standard for redetermining excess profits. No single test or standard of universal application can be prescribed pursuant to which every taxpayer must establish the fair and just amount representing normal earnings to be used as its constructive average base period net income. However, the following principles and rules must be observed in every case in which a constructive average base period net income is determined:

(1) [as amended by T. D. 5415, 1944 Cum. Bull. 404, 406, and T. D. 5560, 1947-1 Cum. Bull. 72] Section 722 (a) provides for the determination of a constructive average base period net income to be used in lieu of the actual average base period net income in those cases to which section 722 is applicable. Therefore, in computing such amount a taxpayer is not entitled to use the rules provided by section 713 (e) (1), relating to increase in base period net income of lowest year of base period, or by section 713 (f), relating to average base period net income in case of increased earnings in last half of base period. Since the constructive average base period net income is the fair and just amount representing normal earnings and will reflect adjustments for abnormally low base period years, a taxpayer having computed such amount is not entitled in addition to apply the rules provided by section 713 (e) (1). In a proper case, however, growth may be

recognized in arriving at the fair and just amount representing normal earnings if, and to the extent that, such recognition is reasonable and consistent with the conditions and limitations of section 722.

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